

# TK Group (2283 HK)

## Backend loaded in 2H19; Maintain Buy

TK posted revenue/NP decline of 2%/19% YoY in 1H19, largely in-line with our estimates and pre-announcement earlier, mainly due to Apple/ Google supply chain reshuffling and GPM decline (27.5% vs 31.5% in 1H18) on competition, euro depreciation and lower utilization. Looking ahead, we expect sales/NP recovery with 20%/14% YoY in 2H19E, driving utilization/margin to rebound HoH. We trimmed our FY19-21E EPS by 5-9% and 12-m TP to HK\$4.09 based on same 8.2x FY20E P/E. Trading at 5.7x FY20E P/E and 33% FY20E ROE, we think the stock is attractive and reiterate BUY.

- Supply chain reshuffling in 1H19; Expect order recovery in 2H19E.** TK revenue slightly declined 2% YoY, largely due to 1) smart home (Google) /comm. equipment (Polycom) down 3%/3% YoY, and 2) mobile & wearable (Apple, Otterbox, Jabra) /automobile growth of 5%/3% YoY,. Despite pricing pressure to persist into 2H19E, we believe wearables/smart home products will maintain strong growth momentum as Otterbox/Jabra/Google will deliver 20%/20%/10% YoY growth in FY19E. Projects-on-hand in 1H19E amounted to HK\$ 979.3mn (+6% YoY), and we believe orders delayed to 2H19E will help ameliorate utilization rate to reach GPM of 30.5% (vs 27.5% in 1H19).
- Relocation to Vietnam and domestic expansion to combat trade war impact.** TK remains cautious on long-term impact from trade war, as its smart home/mobile and wearables products (under US\$ 300bn catalog) are subject to a tariff of 15% from 15 Dec. To mitigate negative effect in near term, mgmt. stated to 1) transfer part of its manufacturing, especially for smart home/mobile, to Vietnam, and 2) actively developing domestic clients, such as e-cigarette, medical appliance (e.g. BAXTER) and personal care (e.g. Philips). Meanwhile, mgmt. guided CAPEX of HK\$100-200mn to support 1) building plant in Vietnam, 2) capacity expansion of Huizhou plant, and 3) Industry 4.0 producing automation for precise molding.
- Stock is attractive at 5.7x P/E and 33% ROE; Maintain Buy.** We trimmed our FY19-21E EPS by 5-9% mainly to reflect lower GPM. We lowered our TP to HK\$4.09 based on unchanged 8.2x FY20E P/E, in-line with its 5-year historical forward P/E. Catalysts include Google/Amazon product launch and margin recovery in 2H19E.

### Earnings Summary

(YE 31 Dec)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue (HK\$ mn)	1,861	2,299	2,528	2,893	3,366
YoY growth (%)	14.4	23.5	10.0	14.4	16.3
Net income (HK\$ mn)	302	350	354	419	510
EPS (HK\$)	0.36	0.42	0.42	0.50	0.61
YoY growth (%)	46.1	15.6	1.0	18.3	21.9
P/E (x)	7.8	6.8	6.7	5.7	4.7
P/B (x)	2.6	2.2	1.9	1.9	1.9
Yield (%)	6.0	7.0	6.7	7.9	9.7
ROE (%)	33.1	32.6	27.8	33.0	40.2

Source: Company data, CMBIS estimates

### BUY (Maintain)

Target Price	HK\$4.09
(Previous TP)	HK\$4.51
Up/Downside	+43.6%
Current Price	HK\$3.37

### China Technology Sector

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#### Stock Data

Mkt Cap (HK\$ mn)	2,808
Avg 3 mths t/o (HK\$ mn)	1.68
52w High/Low (HK\$)	6.32/2.74
Total Issued Shares (mn)	833.3
Source: Bloomberg	

#### Shareholding Structure

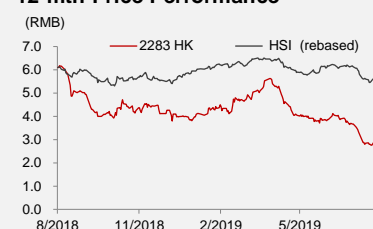
Eastern Mix Co Ltd	39.92%
Pui Leung Li	10.73%
Value Partners	7.84%
Source: HKEx	

#### Share Performance

	Absolute	Relative
1-mth	-8.2%	1.5%
3-mth	-16.6%	-11.1%
6-mth	-25.1%	-16.1%

Source: Bloomberg

#### 12-mth Price Performance

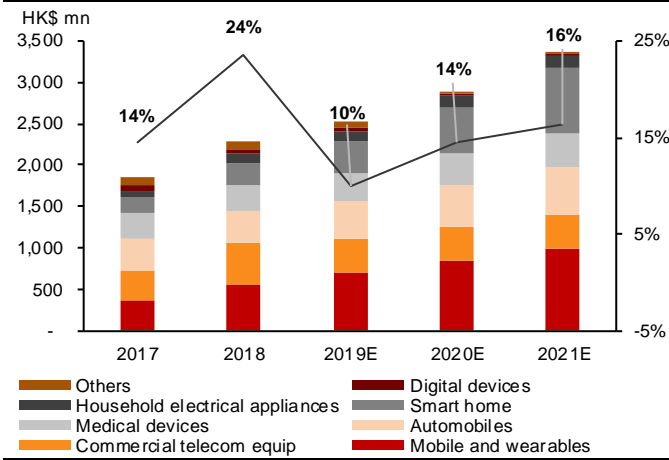


Source: Bloomberg

Auditor: Pricewaterhouse Coopers

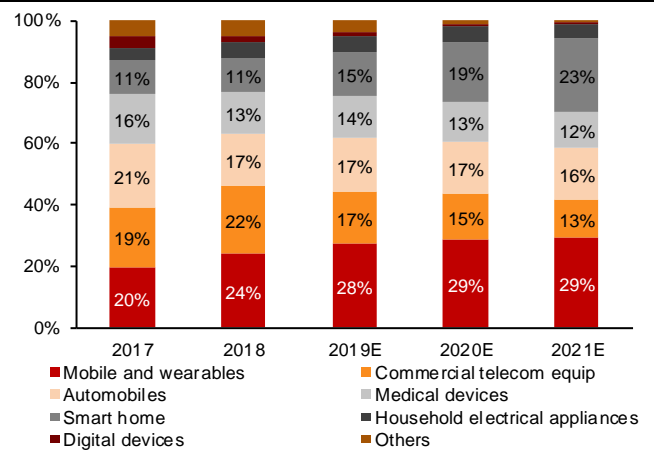
## Focus Charts

**Figure 1: TK revenue trend**



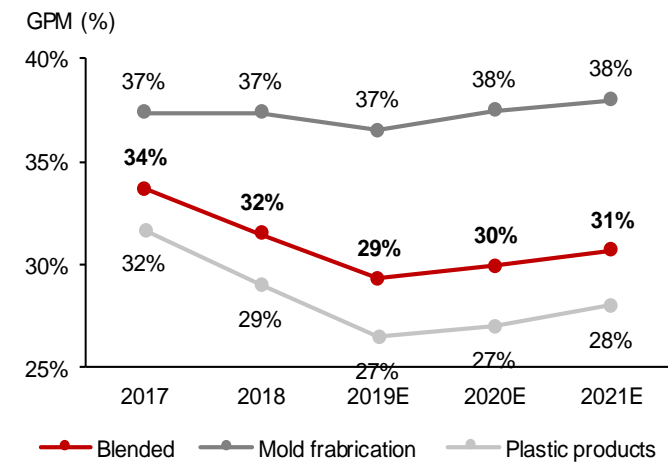
Source: Company data, CMBIS estimates

**Figure 2: TK revenue mix**



Source: Company data, CMBIS estimates

**Figure 3: TK margin trend**



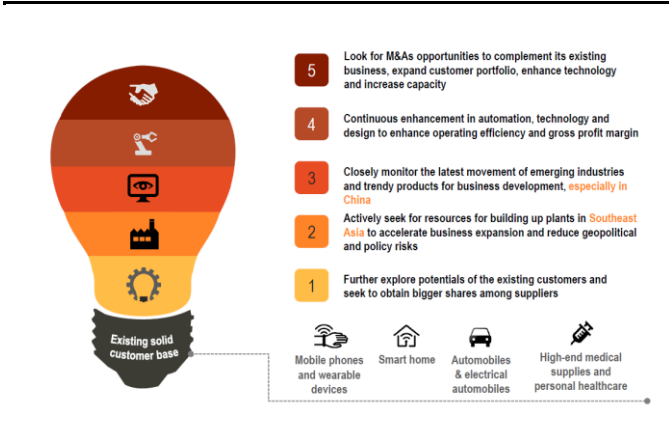
Source: Company data, CMBIS estimates

**Figure 4: 1H19 top six customers**

#	Company name	Industry	Product category
1	Polycom	Commercial telecommunications equipment	Mold and plastic products
2	A leading healthcare product brand	Medical and health care	Mold and plastic products
3	A leading smartphone brand	Mobile phones and wearable devices	Mold and plastic products
4	A leading smart phone accessory brand	Mobile phones and wearable devices	Mold and plastic products
5	A leading audio equipment brand	Mobile phones and wearable devices	Mold and plastic products
6	A 1st tier manufacturer of automobile	Automobile	Mold

Source: Company data, CMBIS estimates

**Figure 5: Development strategies**



Source: Company data, CMBIS estimates

**Figure 6: Fast-growing business segments**



Source: Company data, CMBIS estimates

## Earnings Revision

Figure 7: 1H19 Results Review

HK\$ mn	1H18	2H18	1H19	YoY	CMBI		CMBI		Consensus	
					1H19E	Diff (%)	FY19E	Track (%)	FY19E	Track (%)
Revenue	1,026	1,273	1,005	-2.0%	978	2.8%	2,528	39.7%	2,567	39.1%
Gross profit	323	401	276	-14.5%	275	0.5%	741	37.3%	776	35.6%
Operating profit	163	215	123	-24.6%	131	-6.4%	371	33.1%	404	30.5%
Net profit	140	210	114	-18.7%	114	0.5%	354	32.3%	368	31.0%
EPS (HK\$)	0.17	0.25	0.14	-19.1%	0.14	0.5%	0.42	32.3%	0.44	31.2%
Gross margin	31.5%	31.5%	27.5%	-4 ppt	28.1%	-0.6 ppt	29.3%		30.2%	
Operating margin	15.9%	16.9%	12.2%	-3.7 ppt	13.4%	-1.2 ppt	14.7%		15.7%	
Net margin	13.7%	16.5%	11.4%	-2.3 ppt	11.6%	-0.3 ppt	14.0%		14.3%	

Sources: Company data, Bloomberg, CMBIS

Figure 8: Earnings revision

HK\$ mn	New			Old			Change (%)		
	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
Revenue	2,528	2,893	3,366	2,563	2,932	3,409	-1%	-1%	-1%
Gross profit	741	866	1,033	783	920	1,071	-5%	-6%	-4%
Operating profit	371	440	538	407	489	570	-9%	-10%	-6%
Net profit	354	419	510	385	461	539	-8%	-9%	-5%
EPS (HK\$)	0.42	0.50	0.61	0.46	0.55	0.65	-8%	-9%	-5%
Gross margin	29.3%	29.9%	30.7%	30.6%	31.4%	31.4%	-1.2 ppt	-1.5 ppt	-0.7 ppt
Operating margin	14.7%	15.2%	16.0%	15.9%	16.7%	16.7%	-1.2 ppt	-1.5 ppt	-0.7 ppt
Net Margin	14.0%	14.5%	15.2%	15.0%	15.7%	15.8%	-1 ppt	-1.3 ppt	-0.6 ppt

Sources: Company data, CMBIS

Figure 9: CMBI estimates vs consensus

HK\$ mn	CMBI			Consensus			Diff (%)		
	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
Revenue	2,528	2,893	3,366	2,567	2,914	3,284	-2%	-1%	2%
Gross Profit	741	866	1,033	776	903	1,028	-4%	-4%	0%
Operating Profit	371	440	538	404	477	547	-8%	-8%	-2%
Net profit	354	419	510	368	437	505	-4%	-4%	1%
EPS (HK\$)	0.42	0.50	0.61	0.44	0.52	0.60	-3%	-3%	3%
Gross Margin	29.3%	29.9%	30.7%	30.2%	31.0%	31.3%	-0.9 ppt	-1.1 ppt	-0.6 ppt
Operating Margin	14.7%	15.2%	16.0%	15.7%	16.4%	16.7%	-1.1 ppt	-1.1 ppt	-0.7 ppt
Net Margin	14.0%	14.5%	15.2%	14.3%	15.0%	15.4%	-0.3 ppt	-0.5 ppt	-0.2 ppt

Source: Bloomberg, CMBIS

Figure 10: Revenue breakdown

HK\$ mn	FY17	FY18	1H19	2H19E	FY19E	FY20E	FY21E
Mobile phones and wearable	369	562	241	456	697	837	988
...YoY	25%	52%	5%	38%	24%	20%	18%
Household electrical appliances	74	116	48	83	131	144	158
...YoY	-17%	57%	4%	19%	13%	10%	10%
Medical devices	297	306	136	207	343	377	415
...YoY	36%	3%	0%	22%	12%	10%	10%
Commercial telecom equipment	359	497	205	217	422	422	422
...YoY	-4%	38%	-3%	-24%	-15%	0%	0%
Automobiles	388	398	205	237	442	495	554
...YoY	0%	3%	3%	19%	11%	12%	12%
Smart home	210	256	106	270	376	564	790
...YoY	132%	22%	-3%	84%	47%	50%	40%
Digital devices	70	46	20	13	32	26	21
...YoY	-12%	-34%	-2%	-51%	-30%	-20%	-20%
Others	94	117	43	41	84	28	18
...YoY	1%	25%	-39%	-11%	-28%	-67%	-36%
<b>Total</b>	<b>1,861</b>	<b>2,299</b>	<b>1,005</b>	<b>1,523</b>	<b>2,528</b>	<b>2,893</b>	<b>3,366</b>
...YoY	14%	24%	-2%	20%	10%	14%	16%

Source: Company data, CMBIS

**Figure 11: P&L forecast**

HK\$ mn	FY17	FY18	1H19	2H19E	FY19E	FY20E	FY21E
<b>Revenue</b>	<b>1,861</b>	<b>2,299</b>	<b>1,005</b>	<b>1,523</b>	<b>2,528</b>	<b>2,893</b>	<b>3,366</b>
...YoY	14.4%	23.5%	-2.0%	19.7%	10.0%	14.4%	16.3%
Cost of sales	-1,234	-1,574	(729)	(1,058)	(1,787)	(2,027)	(2,333)
<b>Gross profit</b>	<b>627</b>	<b>724</b>	<b>276</b>	<b>465</b>	<b>741</b>	<b>866</b>	<b>1,033</b>
GPM (%)	33.7%	31.5%	27.5%	30.5%	29.3%	29.9%	30.7%
...YoY	37.4%	15.5%	-14.5%	15.9%	2.3%	16.8%	19.3%
SG&A	-300	-346	(153)	(217)	(370)	(425)	(495)
...% of rev	16.1%	15.1%	15.3%	14.2%	14.7%	14.7%	14.7%
<b>Operating profit</b>	<b>327</b>	<b>378</b>	<b>123</b>	<b>248</b>	<b>371</b>	<b>440</b>	<b>538</b>
OPM (%)	17.6%	16.5%	12.2%	16.3%	14.7%	15.2%	16.0%
...YoY	73.5%	15.6%	-24.6%	15.2%	-2.0%	18.8%	22.1%
<b>Net profit</b>	<b>302</b>	<b>350</b>	<b>114</b>	<b>240</b>	<b>354</b>	<b>419</b>	<b>510</b>
NPM (%)	16.2%	15.2%	11.4%	15.7%	14.0%	14.5%	15.2%
...YoY	46.7%	16.0%	-18.7%	14.2%	1.0%	18.3%	21.9%

Source: Company data, CMBIS

## Valuation

### Maintain BUY with TP HK\$4.09 (44% upside)

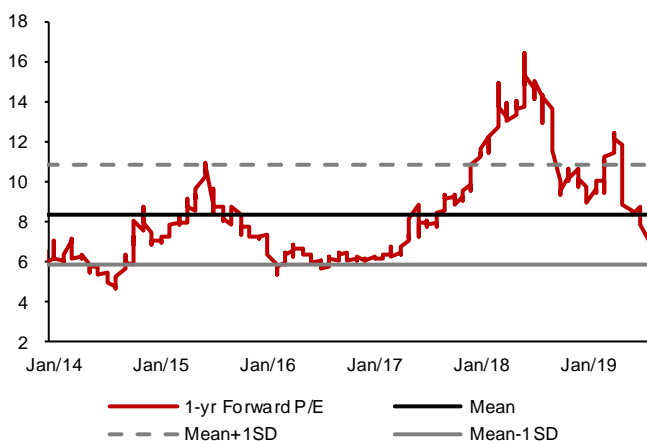
We trimmed our FY19-21E EPS by 5-9% to reflect lower GPM. Our new TP of HK\$4.09 is based on same 8.2x FY20E P/E, in-line with its 5-yr historical forward P/E, which we view as appropriate given our positive view on long-term outlook and improving profitability/ROE.

Upcoming catalysts include Google/Amazon smart home product rollouts and margin recovery with better utilization. Major risks include weaker demand in smart home and wearables, prolonged trade war and weaker macro environment.

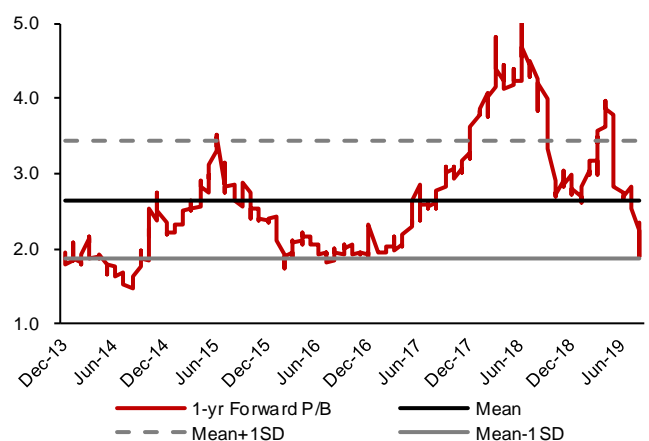
**Figure 12: Peers' valuation**

Company	Ticker	Rating	Market Cap (US\$ mn)	Price (LC)	TP (LC)	Up/Down -side	P/E (x) FY19E	P/E (x) FY20E	P/B (x) FY19E	P/B (x) FY20E	ROE (%) FY19E	ROE (%) FY20E
TK Group	2283 HK	Buy	358	3.37	4.09	44%	6.7	5.7	1.9	1.9	27.8	33.0
Tongda	698 HK	Buy	463	0.56	0.9	63%	4.3	3.7	0.5	0.5	11.7	12.8
BYDE	285 HK	Hold	2,907	10.12	10.4	2%	13.9	9.8	1.2	1.1	8.6	11.2
FIH	2038 HK	NR	953	0.91	NA	NA	-	-	-	-	-	-
HI-P Intl	HIP SP	NR	667	1.15	NA	NA	10.5	10.5	1.5	1.4	15.1	13.8
<b>Average</b>							<b>9.0</b>	<b>7.5</b>	<b>1.3</b>	<b>1.3</b>	<b>16.3</b>	<b>18.4</b>

Source: Bloomberg, CMBIS

**Figure 13: 12M forward P/E band**

Source: Bloomberg, CMBIS

**Figure 14: 12M forward P/B band**

Source: Bloomberg, CMBIS

## Financial Summary

### Income statement

YE 31 Dec (HK\$ mn)	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Revenue</b>	1,861	2,299	2,528	2,893	3,366
COGS	(1,234)	(1,574)	(1,787)	(2,027)	(2,333)
<b>Gross profit</b>	627	724	741	866	1,033
Selling and marketing	(85)	(88)	(92)	(107)	(125)
Other admin exp.	(215)	(258)	(278)	(318)	(370)
<b>Operating profit</b>	327	378	371	440	538
Financial cost	(2)	(3)	(3)	(3)	(3)
Other income/(losses)	24	32	44	49	58
<b>Pre-tax profit</b>	350	407	411	487	593
Tax	(48)	(57)	(58)	(68)	(83)
Minority interest					
<b>Net profit</b>	302	350	354	419	510

### Cash flow summary

YE 31 Dec (HK\$ mn)	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Profit before taxation</b>	350	407	411	487	593
Depreciation/amortization	77	88	97	112	127
Change in working capital	(4)	14	(163)	44	(197)
Others	(23)	(18)	(32)	(44)	(53)
<b>Net cash from operating</b>	400	491	313	599	470
Capex	(114)	(261)	(152)	(188)	(219)
Other	(1)	(23)			
<b>Net cash from investing</b>	(115)	(284)	(152)	(188)	(219)
Net borrowings	(101)	244	39	0	0
Dividend paid	(124)	(150)	(159)	(188)	(230)
Share issuance/(repurchase)					
Other	99	(88)	(3)	(3)	(3)
<b>Net cash from financing</b>	(126)	6	(124)	(191)	(232)
<b>Net change in cash</b>	159	214	38	220	19
Cash at beginning of the year	381	541	754	792	1,012
Exchange difference	1	(1)	0	0	0
<b>Cash at the end of the year</b>	541	754	792	1,012	1,031

### Balance sheet

YE 31 Dec (HK\$ mn)	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Current assets</b>	1,203	1,574	1,727	2,027	2,216
Cash & equivalents	541	754	792	1,012	1,031
Account receivables	292	302	321	392	437
Inventories	305	343	440	449	574
Pledged bank deposits		85	85	85	85
Other current assets	9	10	11	11	12
<b>Non-current assets</b>	436	590	593	654	729
PPE	416	516	543	604	679
Other non-current assets	20	73	50	50	50
<b>Total assets</b>	1,639	2,163	2,319	2,681	2,945
<b>Current liabilities</b>	643	807	652	784	767
ST borrowings	33	107	190	190	190
Account payables	264	308	260	384	357
Other current liabilities	346	392	202	209	219
<b>Non-current liabilities</b>	84	281	109	109	109
LT borrowings	65	235	63	63	63
Other non-current liabilities	19	46	46	46	46
<b>Total liabilities</b>	727	1,088	762	893	876
Share capital	83	83	83	83	83
Reserves	828	992	1,187	1,187	1,187
Minority interest					
<b>Shareholders' equity</b>	912	1,075	1,270	1,270	1,270
<b>Total equity and liabilities</b>	1,639	2,163	2,032	2,163	2,146

### Key ratios

YE 31 Dec	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Sales mix (%)</b>					
Mobile and wearables	20	24	28	29	29
Telecom. equipment	19	22	17	15	13
Automobiles	21	17	17	17	16
Medical devices	16	13	14	13	12
Smart home	11	11	15	19	23
Household elec. appliance	4	5	5	5	5
Digital devices	4	2	1	1	1
Others	5	5	3	1	1
<b>Growth (%)</b>					
Revenue	14.4	23.5	10.0	14.4	16.3
Gross profit	37.4	15.5	2.3	16.8	19.3
Operating profit	73.5	15.6	(2.0)	18.8	22.1
Net profit	46.7	16.0	1.0	18.3	21.9
<b>Profit &amp; loss ratio (%)</b>					
Gross margin	33.7	31.5	29.3	29.9	30.7
Operating margin	17.6	16.5	14.7	15.2	16.0
Net profit margin	16.2	15.2	14.0	14.5	15.2
<b>Balance sheet ratio</b>					
Net debt/total equity (x)	Net cash	Net cash	Net cash	Net cash	Net cash
Current ratio (x)	1.9	1.9	2.6	2.6	2.9
Receivable turnover days	51.8	48.9	37.6	48.5	38.7
Inventory turnover days	90.4	79.6	89.9	80.8	89.8
Payable turnover days	78.1	71.4	53.1	69.2	55.9
<b>Profitability (%)</b>					
ROE	33.1	32.6	27.8	33.0	40.2
ROA	18.4	16.2	15.2	15.6	17.3

Source: Company data, CMBIS estimates

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